Competitive Markets Work: The Evolution of Ohio's Competitive Electricity Market

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Chairman Glenn, Vice Chair Hauck, and Minority Vice Chair Lasinski thank you for the opportunity to provide this testimony today. First, let me preface my comments by offering this disclaimer: the observations and comments included in my presentation are mine alone and do not necessarily reflect the views of Vorys Advisors or any clients of mine or the firm.

Allow me to give you some perspective on my background. It is important to acknowledge that I lived in Michigan from 1993 – 1995, first in greater Detroit and then in Grand Rapids, where our son was born so I have a certain affinity to the state on Ohio's northern border, lest my affiliation with the state to your south create consternation for any member of this Committee.

My relevant professional background is as follows. I was elected to the Ohio House of Representatives in 2008 and re-elected in 2010 representing Ohio's 50th House District. As State Representative I served on the House Alternative Energy Committee and the House Public Utilities Committee, first as Ranking Member and then as Chairman. I left the House during my second term to assume the role of the Chairman of the Public Utilities Commission of Ohio (PUCO) where I served more than 3 years before leaving the PUCO upon expiration of my term. In my capacity as Chairman of the PUCO I also served as the Chairman of the Ohio Power Siting Board, charged with siting and approval of electric generation and transmission projects and intrastate natural gas pipelines in Ohio. During my time at the PUCO I also was a member of the National Association of Regulatory Utility Commissioners, served on its Board of Directors, and as Co-Vice Chair of the Committee on Gas. NARUC, for those who are not familiar, is "a non-profit organization dedicated to representing the State public service commissions who regulate the utilities that provide essential services such as energy, telecommunications, power, water, and transportation. NARUC's members include all 50 States, the District of Columbia, Puerto Rico, and the Virgin Islands."[1]

Since leaving the Commission I have and continue to represent companies in the energy industry, including competitive suppliers, power plant developers, merchant

[1] https://www.naruc.org/about-naruc/about-naruc/

generators, ancillary, and energy services companies on energy policy and strategy, government affairs and regulatory matters.

Setting a Baseline: What is the state of the Industry Today?

The operations of the electricity industry are in a time of tremendous transformation due to new technology, innovation, customer demands, and a changing mix of generation sources. The regulatory construct governing the utility world and the parties that participate in utility and public service commission proceedings is growing. Finally, utilities and their competitors, whether in the wholesale or retail space, are also changing and evolving at a rapid pace in an industry known for slow, cautious adaption and modest incremental change. These pressures occur in a variety of ways, sometimes steadily, sometimes in fits and starts, but change is a constant part of an industry that craves certainty and predictability. There exists a certain tension between market participants that has long existed but due to the speed of transformation today it draws particular attention to the issue of competitive markets.

Different states around the country have adopted different models to ensure families and businesses are delivered utility service, determine how much is paid for those services, and ensure service is delivered in a safe and reliable manner. On the one hand, since the mid-1990's fourteen states and the District of Columbia elected to pursue restructured markets and offer customers the opportunity to choose the source of their supply. Typically, in those places companies compete for customers in the areas of generation and retail supply (the distribution system remains a natural monopoly regulated at the state level) and customers choose the best, most innovative, and most efficient competitors that meet their specific requirements. No one model has been adopted by all the restructured states.

On the other hand, the balance of states has remained vertically integrated and operates in the same manner they have for more than 100 years under a vertically integrated utility model. Under the traditional model integrated utilities provide all services – generation, transmission and distribution – in a franchised service territory (meaning no one can compete in their service territory). In exchange for this monopoly, the utility serves all

customers within its service boundary and in exchange its rate of return is authorized by state regulators.

State regulation and federal regulation are not mutually exclusive. Ohio is a part of the PJM Interconnection. PJM operates the largest energy market in the United States and is arguably the best functioning power market in the world. PJM's value proposition, or the reason organizations participate, is $2.8 to 3.1 billion in annual savings to market participants.[2] Ohio's utilities volunteered to join PJM and successfully completed the transition in the late 2000's. The PUCO is a member of the Organization of PJM States (OPSI) which ensures a continual dialogue between state regulators and PJM. Not surprisingly, criticisms about PJM, some perhaps merited and some not, by those who favor or disfavor participation in organized markets are commonly used as reasons to either join organized markets. It has been my experience that the reasons for or against joining an organized market are typically financially driven and subject to change.

A common reason given not to participate in organized market is that "PJM isn't really a market, it's a 'market construct'" and therefore should be dismissed in favor of purely state jurisdiction. In reality no industry is a pure market as Adam Smith might define it and no state has exclusive jurisdiction over all matters impacting its utility operations. What is true is that whether vertically integrated or re-structured the electric utility industry is highly regulated at both the state and federal level by state PSCs, the Federal Energy Regulatory Commission, the North American Electric Reliability Corporation, the Nuclear Regulatory Commission, the Department of Energy, the US Environmental Protection Agency, the Securities and Exchange Commission, state EPAs, states' attorneys generals and more. Market or no market, the industry remains highly regulated.

Another common objection to participation in an RTO or ISO is that states joining an RTO/ISO "give all control to the federal government and states lose all power." This too is inaccurate. Retail transactions remain a state regulated issue and wholesale power

[2] *See* http://www.pjm.com/about-pjm.aspx, PJM Value Proposition.

transactions remain a federally regulated issue just as they are today – wholesale transactions, even within one state – are FERC regulated.

Finally, I have heard the complaint about length or complexity of tariff filings and complications from participating in an RTO/ISO as a reason not to participate in certain markets. I find it odd that utilities whose entire business is built on tariffs, sometimes quite lengthy, and filings before state and federal regulators that number in the hundreds of pages are suddenly unwilling or unable to work within the confines of a tariff utilized by another organization. Perhaps the reasons are less about complexity and instead driven by self-interest.

Finally, no regulatory system is perfect. All systems – competitive and regulated – have issues that evolve out of the operations of and changes in the marketplace. In general, competitive markets lower prices, drive efficiency, shift risk and deliver lower costs to consumers. We can test this theory in this way: tell me what your electric rates are today and then tell me what the rates will be next year. Under the regulatory framework in place in Michigan now, it is almost a certainty that prices will be higher. In those states that have pursued re-structuring, like Ohio, customers will have the ability to choose lower cost options should their current provider's costs increase. Overall, in restructured markets costs to consumers have been lower – some states more, some state less. And you don't have to take my word for it, there is a growing body of research that documents those savings using data and removing the opinion of one expert or another.[3]

The Ohio Re-Structuring Experience

My experience in Ohio and our efforts to implement Ohio's restructuring law requires a bit of history lesson. Ohio began implementing a restructured market in 1999 with the passage of Am. Senate Bill 3. Senate Bill 3 required the functional separation of generation and retail sales from the monopoly wires function of the traditional utility. At the time, this legislation was driven by high energy prices and the desire of many of the large

[3] *See* Restructuring Recharged, The Superior Performance of Competitive Electricity Markets 2008 – 2016, Dr. Phil O'Connor, April 2017; Evolution of the Revolution: The Sustained Success of Retail Electricity Competition, Dr. Phil O'Connor and Erin M. O'Connell-Diaz, July 2015. *See also* Electricity Customer Choice in Ohio: How Competition has Outperformed Traditional Monopoly Regulation, Dr. Edwin "Ned" Hill & Dr. Andy Thomas, Nov. 2016.

industrial energy users to lower their energy costs. Implementation of the law commenced but compliance with the statute took longer than most imagined.

Through the PUCO's implementation of SB 3 Ohio took the better part of a decade to transition from full vertical integration to a version of restructuring. Utilities had the option to recover "stranded costs" for power generation facilities constructed based on the traditional assumption that the utilities would recover costs for generating facilities over decades. Simultaneously, Ohio also froze electricity rates for a period of years (rate stabilization plans) to ensure customers would not be impacted by potentially higher prices once exposed to the market. Ohio's utilities took different approaches to comply with the re-structuring statute and only one utility had actually complied by 2008.

In 2008, Ohio revisited its restructuring statute by passing Senate Bill 221 which had two main objectives: (1) to create a mechanism to balance utility rate filings to protect customers from higher prices by establishing the Electric Security Plan (ESP) or Market Rate Offer (MRO) choice at the utility's discretion, and (2) to create Ohio's renewable portfolio standard. The outcome should have resulted in customers receiving protection from higher prices and ensure utilities a way to secure supply for their non-shopping customers. As I will discuss later, Ohio's customers did not receive the expected benefits of this new statute.

Starting 2011, the PUCO commenced a deliberate effort to move Ohio's utilities into full compliance with Ohio's restructuring law. Utilities that previously had not separated generation from transmission and distribution were ordered, through their ESP cases, to do so. Additionally, utilities were required to transition to a fully competitive wholesale auction utilizing a descending clock auction to secure supply for any non-shopping customers (or the "Provider of Last Resort" or POLR customers) administered by the PUCO. Ohio's utilities chose different compliance paths with one utility choosing a "flash cut" or immediate transition to market. Residential customers experienced an immediate 17% reduction in their rates after the initial auction. Ultimately that utility sold its generation to an independent power producer and operates as a wires utility. A second utility worked through a multi-year transition from a Fixed Resource Requirement (FRR) entity to a 100% auction-based procurement process. Ohio's third and smallest utility remains mired in the transition despite PUCO orders to separate for a variety of reasons. What may resolve this

issue, however, is the market dictating that older, uneconomic plants close. If that is the case, the remaining utility may simply retire its existing generation and exit the generation market completely.

Of note, during the utility's transition from FRR to wholesale auction it was awarded a capacity charge of $188.88/MW day. I understand that capacity charge, which was criticized by some in Ohio at the time for being unreasonable high, is a fraction of the cost of capacity quoted by at least one Michigan utility in this committee for its cost of capacity. For some perspective, the most recent PJM capacity auction in May 2017 resulted in a "rest of RTO" (the unconstrained portions of the PJM territory) capacity charge of $76.53.

As a result of these changes in Ohio's market, the number of competitive suppliers has grown dramatically. The competitive offers available to consumers are incredibly varied[4] and customer shopping has increased dramatically.[5] As was envisioned under SB 3, Ohio today is experiencing a tremendous amount of investment in new generation resources. All of these projects are funded by private capital and are not being undertaken by Ohio's utilities with the risk shifted to shareholders and investors and off of ratepayers.

What does that mean for Ohio customers? In short, significant economic investment and job creation is happening in nearly a dozen communities around Ohio. In the event those plants lose money, cost too much to maintain and operate or be forced to close, the owners and investors bear that risk and ratepayers are not obligated in any way to pay for the plants or the associated costs of operation. This demonstrates that even with shifting risk investment in new infrastructure will be made if the market is allowed to work.

To add detail around Ohio's generation investments let me share some additional items. Today there are more than 10 new generation facilities under development in Ohio.[6] Currently four are under construction, several others have filed their applications with the Ohio Power Siting Board and either received certificates or are in the OPSB approval process, and the others are in the early and middle stages of pre-filing and planning. These

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[4] *See* www.energychoice.ohio.gov to view offers available in Ohio.

[5] *See* Ohio's current shopping statistics: https://www.puco.ohio.gov/industry-information/statistical-reports/electric-customer-choice-switch-rates-and-aggregation-activity/

[6] *See* Exhibit 1.

projects represent nearly 10,000 MW of new natural gas fired generation and an investment in Ohio that could exceed $9 billion.[7] Ohio is also blessed to be sitting atop the Utica Shale formation and the Appalachian Basin has some of the lowest cost natural gas in the world. It important to recognize that Ohio's historical reliance on coal means we have seen approximately 10,000 MW of coal retire since 2008, but the addition of new gas plants ensures Ohio improves its fuel diversity and continues to receive reliable power.[8]

It has become a familiar argument that states should self-supply or generate all the power it needs from within the state's borders and become a net exporter to other states. Policymakers need to begin their analysis by asking this threshold question: do you want your constituents to have lowest cost power or do you want to "control" all of the in-state generation even if it results in higher costs to constituents?

While perhaps a noble goal, the laws of physics and economics make it a physical and economic impossibility. First, the laws of physics prevent every state from exporting power. Power does not flow in a linear fashion meaning it flows across the system to as needed. Power must be delivered instantly and storage is not yet a well-developed source of supply for large volumes or extended periods of time. Second, as a member of the PJM Interconnection, Ohio's energy is supplied regionally from the lowest cost power applying the use of economic dispatch of resources. This ensures that Ohio pays the least cost for power regardless of where it is generated. If those plants happen to be in Ohio, as many of the new, highly efficient natural gas plants are, then Ohio may generate more of its own power, but Ohio has been a net importer of energy for decades due to Ohio's heavy manufacturing base and because utilities had to site power plants in states near Ohio because Ohio customers would not pay for increasing more power plants just to have them located in Ohio. As a result, there are a number of power plants just across the Ohio River in West Virginia and in Pennsylvania that committed their power to Ohio prior to restructuring was implemented. What is more, Michigan's utilities often bid into and win the right to supply generation in Ohio's wholesale auctions.

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[7] *See* Exhibit 2.
[8] *See* Exhibit 3.

Virtually all of the new generation coming to Ohio is from power developers and independent power producers both in the form of new plants and uprating, or adding additional capacity, to existing resources. To be clear, Ohio law allows utilities to construct new generation via their unregulated affiliate and under certain circumstances even by their regulated utility. This establishes a level playing field allowing any market participant who wants to invest to do so. To date, no utility has elected to do so.

With that said the law of unintended consequences impacts policy decisions and lessons are learned about issues that need reform. It has taken Ohio some time to see these issues because for the first 12 years of restructuring in Ohio (1999-2011) there was not an effort to ensure that utilities complied with the statutory requirements and the outcomes observed today did not manifest themselves until now. For example, what has become painfully clear is the ESP process has been abused resulting in layer upon layer of riders to be added to Ohio ratepayers' bills.[9] The result is while electricity *generation* prices have dropped by approximately 50%; overall *utility bill* charges have remained fairly constant or increased. Virtually all of this increase is as result of utility initiated riders secured through the ESP process. Reform of the ESP process has been initiated with the introduction of House Bill 247 in this General Assembly.[10]

Additionally, over time we learn that facts, circumstances, and assumptions can and do change. In 1999 power prices were high, demand was growing, and customers wanted to secure lower cost power from the market. In 2008, before the economic meltdown basic assumptions about load growth (it would increase) and high gas prices (that prices would be high for the foreseeable future) caused policymakers to adjust the law presumably in an effort to protect customers from ever increasing costs. Because those assumptions turned out to be wrong instead of benefiting customers have paid more than they otherwise should have for the same service they were already receiving.

The incorrect assumptions included the discovery and development of Marcellus and Utica Shale gas, flat to declining load growth, changes in technology, and ever changing

[9] The Ohio Consumers Counsel data is attached as *Exhibit 4*.

[10] *See* https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-247, and http://www.cleveland.com/business/index.ssf/2017/05/ohio_electric_utility_rates_ch.html

consumer demands. Taken collectively those factors have fundamentally altered market dynamics. Policy makers could predict none of these with any degree of certainty in 1999 or 2008. What is certain is that change is a constant and the market responds better and faster to those changes than regulators or policy makers.

What Issues are on the Horizon?

As I demonstrated previously, no one can predict with certainty what will happen in the coming years, but I will make a few educated guesses and then share a framework to think about how to consider the possibilities.

First, it has been my experience that a hybrid model is the worst of all models for players on all sides of the competitive markets issue. Some would say that Ohio's regulatory model after the passage of SB 221 is something of a hybrid and in need of reform. As I noted in my previous comments, as a result of implementation items in need of correction have been identified and steps are underway to resolve them and resolve the hybrid question once and for all. Hybrid models inevitably place policymakers in the role of choosing winners and losers. In its worst form it creates a race to the last subsidy and costs unnecessarily increase and the market is distorted further hindering its effective operation where customers can receive economic benefits.

Second, I have heard it has been said that the Ohio model does not work and that Ohio policymakers are looking to go back to a regulated model. That statement is partially true – some of Ohio's *utilities* have for the past several years tried a variety of approaches to move Ohio back toward full re-regulation, but *policy makers* have not made any moves to revert to the traditional model. In fact, the current Zero Emissions Nuclear credit legislation has stopped completely in the Ohio House because there is no appetite to favorably report it out of the House Public Utilities Committee.[11] The reasons for that are quite clear – customers are saving money, investment is occurring in Ohio, and the only parties seeking to correct a perceived problem are the utilities themselves. You should not confuse utility proposals with state policy objectives.

[11] http://www.cleveland.com/business/index.ssf/2017/05/firstenergy_nuclear_hearings_s.html

Third, there are four fundamental questions policy makers should ask in making decisions that support competitive markets. Dr. Ned Hill, co-author of the Electricity Competition in Ohio study, poses the following questions to help guide policy makers in their decision making concerning competitive markets:

1. Are consumers saving money?
2. Is the system reliability improving?
3. Are new entrants investing money in generating plant and equipment?
4. Are uncompetitive power plants exiting the market?

If the answer to these questions is yes, then clearly there is a functioning market. If none of these things is true, then the opposite is true.

In preparing to testify today I have seen testimony that while Michigan's rates are higher than Ohio but bills are lower and that's a good point of comparison. I would take issue with the comparison because it misses the point of competition. In Ohio, customers are not required to pay the higher prices at all. Because all of Ohio's customers can shop for their supplier each family and business has the opportunity to seek out the best option for them and their energy budget. For example, a fixed price product can be selected that eliminates exposure to market prices and potential variability. Customers who want a green power supply can secure one via competitive choice option. Customers can select any number of products that are best suited to match their risk profile, consumption patterns, and environmental goals. So making the claim that higher prices but lower bills is a good choice fails to recognize that lower prices means lower bills *regardless* of the usage and that is good for families and businesses in any state. All consumers benefit when they are given the choice of securing a service in alignment with their objectives.

Finally, because of the good outcomes that result from the expansion of competition and customer choice – investment without ratepayer risk, lower prices, enhanced customer offerings, innovation, and economic growth – more choice is better than less. No system is perfect in its implementation and certainly changes will happen over time. What is required of policy makers is a willingness to plan a course of action, stay the course as the plan is

implemented, and be willing to resolve the inevitable issues that arise. Political courage in the face of criticism is not easy, but establishing a viable framework that allows consumers to receive the benefits of the competitive marketplace while ensuring the market remains attractive to investment by market participants of all types has long lasting benefits. It is not helpful to look backward and default back to the regulatory model from the 1950's that is not reflective of the realities of the 21st century.

Thank you again for the opportunity to testify today and I look forward to answering any questions you may have.

EXHIBIT 1

Total Economic Impact of New Generation

Investment: ~ $9 billion

MW capacity: 9,157

Job creation: > 10,000

For more information, please contact

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EXHIBIT 2

Gas Fired Generation in Ohio

Plant	Size (MW)	Status
Fremont Energy Center	710	Operating
Oregon Clean Energy Center	960	In construction (COD 5/'17)
Carroll Co. Project	742	In construction (COD '18)
Middletown Project	525	In construction (COD '18)
Lordstown Energy Center	940	in construction (COD 6/'18)
Subtotal	3,877	
Columbiana Co.	1,152	COD 2019 ; PJM Q AA1-123
Trumbull Energy Center	940	COD 2020 ; PJM Q AB1-105
Oregon Energy Center	955	COD 2020 ; PJM Q AB1-107
Guernsey Co.	1,650	COD 2020 ; PJM Q AB2-067/AC1-044
Hannibal, OH	485	COD 2020 ; PJM Q AB2-093
Harrison Co.	1,277	COD 2021 ; PJM Q AC1-096
Subtotal	6,459	
Total in Ohio	**10,336**	

EXHIBIT 3

Ohio's Generation Fuel Mix

	2000	2015
Coal	79%	56%
Natural Gas	13%	34%
Nuclear	7%	8%
Other	1%	2%

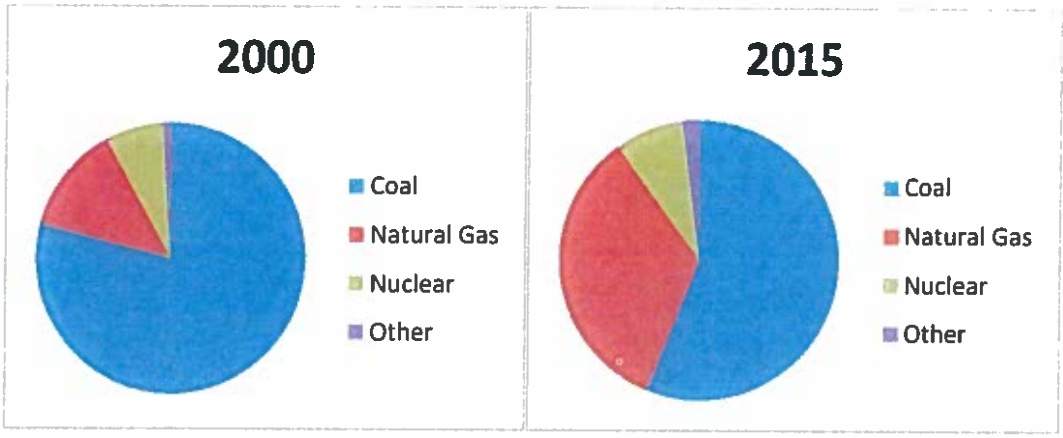

EXHIBIT 4

Problem for Consumers: Single-Issue Ratemaking

Utility	Number of Riders
FirstEnergy - Cleveland Electric Illuminating	32
FirstEnergy - Ohio Edison	30
FirstEnergy - Toledo Edison	30
American Electric Power Ohio	25
Duke Energy	17
Dayton Power and Light	7